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Supreme Court, U.S.
FILED
FEB 0 6 2007
OFFICE OF THE CLERK

No. 06-666

IN THE

Supreme Court of the United States

DEPARTMENT OF REVENUE OF THE COMMONWEALTH OF KENTUCKY and FINANCE AND ADMINISTRATION CABINET OF THE COMMONWEALTH OF KENTUCKY,
Petitioners,

versus

GEORGE W. DAVIS and CATHERINE V. DAVIS,
Respondents.

On Petition for a Writ of Certiorari to the Court of Appeals of Kentucky

REPLY BRIEF FOR THE PETITIONERS

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REPLY BRIEF FOR PETITIONER

The Respondents' Brief in Opposition (Opp. 18-19) argues that the petition is "premature" and that other courts should be allowed to "weigh in" on the issue presented. The petition is certainly not premature for the Commonwealth of Kentucky, where the Constitution will have a meaning different from that in Ohio (and all the other states) if the Kentucky Court of Appeals decision is allowed to stand. If the petition is not granted, the Commonwealth will have to accord its bonds the same tax treatment as bonds issued by its sister states and their political subdivisions. *See, e.g.*, *McKesson* v. *Division of Alcoholic Beverages and Tobacco, Department of Business Regulation of Florida*, 496 U.S. 18 31-36, 51-42 (1990); *Davis* v. *Michigan Dept. of Treasury*, 489 U.S. 803, 817-18 (1989). Meanwhile, its sister states and their political subdivisions will be under no obligation to do the same with respect with to bonds issued by the Commonwealth and its political subdivisions, unless their courts opt for the approach taken by the Kentucky Court of Appeals in this case over that taken by the Ohio courts.

Moreover, the Respondents do not make any showing as to what benefit would be derived from "full develop[ment]" of the issue in the Arizona and North Carolina courts. Opp. 19. They do not articulate what that "full develop[ment]" would consist of, either. The reality is that no benefit would lie in awaiting further state court decisions on the issue presented. This issue is purely one of law that can only be settled by this Court. The area of controversy presented by this case is not one that is evolving in nature or depending upon factual development or exploration of doctrinal ramifications.

Instead, the Respondents' approach only significantly delays the resolution of a question of great national importance. There has been no reported decision in the Arizona case to which the Respondents refer. The North Carolina litigation, which is also being handled by the Respondents' counsel, is focused on the question of class certification and

not the merits, *Dunn* v. *State*, 635 S.E.2d 604 (N.C. App. 2006), and is on review to the North Carolina Supreme Court. *Dunn* v. *State*, Supreme Court of North Carolina Docket No. 605P06 (available at http://www.aoc.state.nc.us/www/public/sc/dsheets/605-06-1.htm).

At the same time, the Respondents have not disputed the widespread and substantial impact of the issue presented upon the great majority of the states. On this point, the National Association of State Treasurers, a nonprofit association whose members "include the Treasurers or similar State financial officers of all 50 states," has sought leave to file a brief as amicus curiae in support of the Petitioners. Amicus Br. 1. That brief explains the "vital importance" of municipal bonds "to State and local government entities that issue [them] and to citizens who benefit from government projects and activities financed by [them]," and "the centrality of [the bonds'] tax exempt status." Amicus Br. 4-13. The National Association of State Treasurers "strongly urges the Court to grant review," as the decision of the Kentucky Court of Appeals "has created legal uncertainty that should be resolved promptly, and can only be resolved by this Court." Amicus Br. 4, 5.

The Respondents assert that the petition should be denied because the Kentucky Court of Appeals' decision is "wholly consistent with this Court's extensive Commerce Clause precedent." Opp. 3. They fail to heed this Court's admonitions that "our opinions are to be read in the light of the facts of the case under discussion," *Armour & Co.* v. *Wantock*, 323 U.S. 126, 132-33 (1944), and especially so in the area of the dormant Commerce Clause. *Boston Stock Exchange* v. *State Tax Commission*, 429 U.S. 318, 329 (1977); *Freeman* v. *Hewitt*, 329 U.S. 249, 252 (1946). The Respondents' whole case is premised upon the approach that principles enunciated by this Court in its dormant Commerce Clause jurisprudence must be inexorably followed as far as logic can

carry them, regardless of the context or the possibility of the application of countervailing principles. None of the cases upon which they rely bear any resemblance to the facts or context presented by this case.

The Respondents' argument extends the application of the dormant Commerce Clause well beyond its purpose as expressed by this Court in cases such as *H.P. Hood & Sons, Inc.* v. *Du Mond*, 336 U.S. 525 (1949):

> Our system, fostered by the Commerce Clause, is that every farmer and every craftsman shall be encouraged to produce by the certainty that he will have free access to every market in the Nation, that no home embargoes will withhold his export, and no foreign state will by customs duties or regulations exclude them. Likewise, every consumer may look to the free competition from every producing area in the Nation to protect him from exploitation by any. Such was the vision of the Founders; such has been the doctrine of this Court which has given it reality.

Id. at 539. This case does not involve a measure aimed at the products of a farmer, craftsman or economic interest of another state, but instead concerns whether the means chosen by a state to raise funds to support general government needs or to fund public works projects or programs is qualified by some obligation to it's sister states imposed by the Commerce Clause. The proper answer is that the Constitution specifically addresses the obligations the states owe one another and the obligation advanced by the Respondents is not among them. *Bonaparte* v. *Tax Court*, 104 U.S. 592 (1881); U.S. Const. Art. IV, §§ 1-3.

To be sure, the states may not discriminate against interstate commerce and Kentucky has not done so here. Kentucky taxes interest derived from bonds issued by its sister states and their political subdivisions in the same manner as interest from bonds issued by Kentucky's intrastate businesses. That is all the dormant Commerce clause requires

here, given the status of those bonds beyond their borders. *Bonaparte*, 104 U.S. at 595; *Georgia* v. *Chattanooga*, 264 U.S. 472, 480-81 (1924).

Finally, the Respondents tout the virtues of their position as imposing some form of fiscal discipline upon the states. They assert that "[o]nce states compete in the financial markets without the protective benefit of coercive tax schemes, they will have to be more selective in what projects they choose to fund," since "[t]hey will [be] compet[ing] for investors' dollars not just with respect to the interest rate offered, but on the merits of the projects funded by the investment sales." This theory is completely antithetical to the status of the states under the Constitution as autonomous and independent sovereign entities. *Alden* v. *Maine*, 527 U.S. 706, 713-15 (1999); *New York* v. *United States*, 505 U.S. 144, 162-63 (1992); *Erie R. Co.* v. *Tompkins*, 304 U.S. 64, 78-79 (1938). The states vary considerably in the needs and problems they and their citizens face and these needs and problems can change over time and even suddenly, such as in the event of a natural disaster or economic dislocation. "[O]ne of the happy incidents of the federal system [is] that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the county." *New State Ice Co.* v. *Liebmann*, 285 U.S. 262, 311 (1932)(Brandeis, J., dissenting). The states may therefore undertake projects or programs that may not necessarily be highly regarded by the financial markets at the time of their adoption. These projects and programs may be "experiments" that stand the test of time and experience, however, and ultimately prove worthy of emulation by other states and their local governments or even by the National Government. Such is a large part of the nature and genius of the federal system established by the Constitution.

These programs and projects may also be devoted to purposes and values that transcend any value that may be placed upon them by the financial markets - - e.g., the rebuilding of the infrastructure of a city stricken by natural disaster, the establishment of war memorials, the erection of courthouses and other public buildings. The states and their political subdivisions should not be forced into competition with other states, as the Respondents contend, in appealing to their taxpayers for the funding of those programs and projects. "In Chief Justice Chase's much-quoted words, 'the preservation of the States, and the maintenance of their governments, are as much within the design and care of the Constitution as the preservation of the Union and the maintenance of the National government. The Constitution, in all its provisions, looks to an indestructible Union, composed of indestructible States.'" *New York* v. *United States*, 505 U.S. at 162 (quoting *Texas* v. *White*, 7 Wall. 700, 725, 19 L.Ed. 227 (1869)). The Respondents' position is at odds with this fundamental principle. Their position would deny the states an important means of meeting their financial needs and instead pit the states against each other for the funding they need.

As sovereign entities under our federal system of government, the states must necessarily have the flexibility to order their fiscal affairs as they see fit to meet the challenges they face. One of the means by which the states can finance public projects and programs to address these challenges is to appeal to their taxpayers for loans of the necessary funds, employing the inducement of a tax exemption. As we have seen, this is a widespread practice that lowers the cost of borrowing for the many state and local governments that employ it. Pet. 7-11; Amicus Br. 6-7, 8-10. The Respondents may have policy arguments and studies that inveigh against this practice, but these policy arguments and studies have obviously not carried the day in the vast majority of the states. Pet 7-8. In the final analysis, under the Constitu-

tion it is the prerogative of the states as sovereign entities to decide for themselves the approach to take.

CONCLUSION

For the foregoing reasons and those stated previously, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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